

Co-operative Apartment Investment

By V. C. ROSS

This is the last in a series of six consecutive articles, the first of which appeared in the August 15 issue. The author, Mr. V. C. Ross, is a well-known authority on the subject of financing co-operative apartment houses

Reprinted from **The SPUR**

NOVEMBER 1st, 1927

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THE modern co-operative apartment ownership plan has so consistently accomplished the purposes for which it was designed that co-operative apartment enterprises are now being successfully conducted in almost every large city in the United States and in many of the smaller residential communities. The character and business standing of the individuals who are satisfied owners of co-operative apartments are very positive evidences of the high opinion with which the modern co-operative apartment ownership plan is considered from an investment viewpoint. Many of the most able and conservative architects, attorneys, bankers, brokers, builders, business executives and real estate dealers in New York are contented owners of co-operative apartments. The unqualified endorsement of the modern co-operative apartment ownership plan by those who are best qualified by training, experience and expert knowledge to pass upon its soundness is a recommendation that no homeseeker can afford to overlook.

Co-operative home ownership projects have been organized by groups of individuals who have decided to erect new buildings in which they could live as neighbors as well as by groups of tenants who have decided to purchase the existing buildings in which their apartments were situated. Such projects have also been organized by large land owners, real estate dealers, architects, engineers and builders.

A co-operative apartment building may contain only two or three apartments or it may contain more than a hundred. Many of the buildings now being built contain about twenty apartments. One recent building contains one hundred and twenty moderately priced apartments, all of which were bought before the building was ready for occupancy. A co-operative apartment may contain only two or three rooms or it may contain twenty or thirty rooms. Many of the apartments now being offered for sale contain eight or nine rooms. One New York City apartment contains thirty rooms. Co-operative apartments may be priced at anywhere from about \$4,000 upward. An excellent apartment may be bought for less than \$20,000. One large New York City apartment was recently bought for \$450,000.

Some of the largest and most valuable apartments in the world are among those co-operatively owned in the Park and Fifth Avenue areas of New York City. A recent survey of co-operative apartment buildings in the Borough of Manhattan showed that there were more than one hundred such buildings in the area east of Fifth Avenue, which represented an investment of approximately \$132,000,000. New buildings planned since the making of this survey bring the total amount of co-operative apartment capital invested or presently to be invested in this area up to approximately \$160,000,000. There are also very sub-

stantial co-operative apartment investments in other areas, such as Washington Square, the Upper West Side, Hudson View Gardens, Brooklyn Heights and Jackson Heights. A tremendous amount of capital has been invested in co-operative apartments everywhere and it is believed that the amount so invested in Greater New York to-day is substantially in excess of \$200,000,000. The extent of this investment is one evidence of the favor with which modern co-operative apartments have been received by investors and home owners.

While most co-operative apartment ownership groups hold their properties in fee ownership, a few such groups hold only leasehold estates in the apartment buildings which they operate. There is no reason why a leasehold apartment property cannot be as successfully organized and operated, on a co-operative ownership basis, as a fee property. Owners who have been unable or unwilling to convey full permanent ownership of real property have long been accustomed to transfer lesser estates by granting long term leaseholds. The grantee of a long term leasehold acquires what amounts to complete dominion over the leased property for the term specified in his lease. Many valuable apartment and business buildings in New York City, notably those now standing on railroad property in the Grand Central area, have been built upon leasehold land. Several leasehold apartment properties on Park and Fifth Avenues are now being successfully operated by co-operative apartment corporations.

The co-operative apartment corporation which acquires a leasehold property must have a financial structure materially different from that of the corporation which owns a fee property. A modern leasehold estate is usually granted for a term of twenty-one years with the right to three renewals of twenty-one years each, making the total possible period of possession eighty-four years. The co-operative apartment corporation to which such a leasehold is granted must assume the payment of a rental equivalent to five or six per cent. of the appraised value of the leased land and this value must in most cases be reappraised at the beginning of each renewal term of the leasehold. At the expiration of the last renewal term the land, with all buildings and improvements then standing thereon, reverts to the owner of the fee. Although leasehold estates are often mortgaged, the co-operative apartment corporation which owns a leasehold usually has no mortgage indebtedness and no mortgage refinancing problems. To offset the loss of the property upon the expiration of the lease, the operating and maintenance charges of a co-operative apartment corporation of this type are usually made large enough to provide a sinking fund which will be sufficient at the expiration of the lease to reimburse the stockholders of the co-operative apartment corporation for the entire amounts of their original investments. Because of the length of the term of a lease of this kind and its renewals a very small sum set aside annually will be sufficient to establish such a sinking fund.

Whether or not they are built on land owned in fee or on land held under leasehold, most of the apartment buildings which are success-

fully owned and operated on a co-operative ownership basis are buildings to which the modern co-operative apartment ownership plan has been fully applied. When the plan is fully applied, substantially all of the space in the building is owned and occupied by members of the co-operative ownership group and there can be no vacancies. Buildings fully occupied by their owners are usually known as "100% Co-operatives" to distinguish them from buildings to which the co-operative ownership plan has been only partially applied.

There are also many buildings to the ownership of which the modern co-operative apartment ownership plan has been successfully applied in a limited manner. When the plan is partially applied, somewhat less than all of the space in the building is owned and occupied by members of the co-operative ownership group and the remainder of such space is offered for rent to the public. This form of ownership is often known as "partially co-operative" or "group" ownership to distinguish it from fully co-operative ownership.

When an apartment building is held under partially co-operative or group ownership, the entire building is operated for the benefit of only a few of its occupants. These own the equity in the building through the instrumentality of a holding corporation. Each member of the group holds stock in this corporation which has a value equivalent to the amount of capital he has contributed. Each such member also has a right to the exclusive occupancy of one or more apartments by virtue of an agreement with his associates or of a proprietary lease from the holding corporation. Group members usually occupy between twenty and fifty per cent. of the space in the apartment building and offer the remainder for rent. The revenues received from rentals of the apartments which group members do not occupy are applied to the payment of operating and maintenance charges and to the amortization of the mortgage indebtedness of the holding corporation. To the extent that such revenues suffice for the payment of these expenses the group members are relieved of responsibility therefor. When all of the available apartments are rented, group owners are often able to enjoy their own apartments without paying maintenance expenses of any kind. In some cases the holding corporation actually earns a considerable surplus which can be used either for the prepayment of mortgage indebtedness or for the payment of dividends to the group members.

An apartment investment in a partially co-operative building has greater possibilities of both profit and loss than an investment in a 100% co-operative building. The success of the partially co-operative investment depends upon the success with which apartments can be rented. When renting is easy, profits will be large, and when renting is difficult, there may be no profits. Investors in partially co-operative enterprises are always exposed to the risk of losses from vacancies and most of the other expenses and losses which an ordinary landlord cannot avoid, such as expenses of advertising vacancies, losses from uncollectible rents, renting brokerage commissions and expenses of repairing and redecorating the rented apartments. An investor who

holds only a minority of the stock of the holding corporation which owns a partially co-operative apartment building is also almost always exposed to the risk of being outvoted by a small group of his associates. Many apartment investors consider these risks as of slight importance when compared with the possibilities of large profits and low or free maintenance which various plans of group ownership afford. Many other investors prefer to avoid all such risks by purchasing apartments in a 100% co-operative building.

Each co-operative apartment enterprise must be judged on its own merits and by much the same standards as would be applicable to any other enterprise. The success of a particular apartment ownership project will depend chiefly upon the extent to which five fundamental requirements have been satisfied. There must be:

1. A Well Chosen Location,
2. A Well Built Building,
3. Intelligent Organization and Finance,
4. Competent Management, and
5. A Respectable and Responsible Ownership Group.

The probable life of a modern high-class apartment building has been estimated at fifty years. To demolish it or convert it to any other than residential use would be a very expensive work. It is therefore essential at the outset that a building of this type be erected upon a well chosen site. The site must be in an area which has, and is likely to continue indefinitely to have, a high-class residential character. The site should also be in an area in which land values are stable or in which such values show promise of future increase. An apartment building built upon a site of this kind is apt to have the longest usefulness to the co-operative ownership group. Any increase in the value of an absolutely owned apartment property will be reflected by a proportionate increase in value of the investment of each member of the group.

An apartment building cannot have a long life unless it is well built. Careless workmanship or the use of materials of poor quality always causes conditions which must eventually be corrected at the expense of the co-operative apartment corporation. Inferior construction increases maintenance costs and decreases rental values. Any apartment building which complies with all the applicable laws and ordinances as well as the rules and orders of the New York City Building and Tenement House Departments must be reasonably well built. If final certificates of occupancy are issued by these departments there is at least a presumption that a building is in most respects well built and that it conforms to the plans and specifications in respect of which a building permit was originally issued. When these plans and specifications have been prepared and the construction and equipment of the building have been supervised by an experienced apartment house architect there is a presumption that the building has been properly constructed. Almost all of the institutions which agree to make mort-

gage loans upon the security of apartment buildings employ the services of a staff of experts for the purpose of determining whether or not such buildings have been or are being competently constructed. When a co-operative apartment building is mortgaged to an institution which has a staff of this character it may be assumed that the lender has satisfied himself by independent investigation that the construction is or will be of the proper quality.

When a new building is to be constructed for sale to co-operative apartment purchasers, it is essential that the building plans and specifications be adequate in the first instance and that they be conscientiously carried out in the construction which follows. The equipment of the building must be modern and complete. Prospective apartment purchasers who find it difficult or impossible to understand detailed plans and specifications can always get intelligent advice from a disinterested architect of good standing at a moderate cost. The individual who agrees to purchase an apartment from plans must have confidence in the honesty and ability of the builder who is to construct the new apartment building. If the record and character and standing of the builder are all of the best, the investor may ordinarily assume that the building will be constructed in a satisfactory manner.

A successful co-operative apartment enterprise must also be intelligently organized and financed. The legal plan must be sound and framed in such a way as to fix the rights and responsibilities of the members of the co-operative ownership group as between themselves and also as between each member of the group and the co-operative apartment corporation. The apartment corporation must be organized in such a way as to enable the apartment owners, who are its stockholders, to have the benefit of every possible tax exemption and immunity from personal liability. The title to the apartment property must be good and marketable and properly vested in the apartment corporation.

The cost of the land and completed building to the co-operative ownership group must be consistent with their appraised values. It is not difficult to obtain reliable appraisals of the value of land and a completed building as soon as plans are drawn, particularly in sections where land values are stable and constitute a large part of the investment. This value must include organization expenses, a builders' profit and reasonable carrying charges during construction. It is essential that the co-operative apartment corporation should not acquire its property at an excessive valuation. The price for which the entire property is to be acquired must be fairly apportioned among the various apartments. The financial set up must be practicable. The permanent mortgage financing must be adequate but not too costly or too large to be capable of easy replacement. The mortgage debt service charges must not be or be likely to become unduly onerous. If the mortgage requires no amortization a separate mortgage sinking fund should be provided.

Estimates of annual operating expenses and maintenance charges must be adequate. The most reliable estimates are those prepared by competent real estate organizations which have had considerable experience in the operation of apartment properties of a similar class. The total of the estimated annual maintenance charge plus the annual interest on the purchase price of each apartment should be substantially less than the annual rental value of that apartment. Most co-operative apartment buildings are built in localities where apartments of various sizes have well established annual rental values and it is seldom difficult to make this comparison.

The organizers of a co-operative apartment enterprise must be persons of unquestionable business and financial standing. They are responsible for the sound and economical planning of the enterprise. Many ultimate savings can result from the foresight of the organizers. When the enterprise concerns a new building, the organizers must be financially able to purchase and pay the maintenance charges of all apartments which are not sold to tenant investors. They must be able ultimately to deliver to the co-operative ownership group a completed building in respect of which there is no indebtedness except that occasioned by the permanent mortgage financing. Individuals who purchase apartments are often obliged to depend to some extent upon representations and promises made by organizers of co-operative enterprises. Investors should have no business dealings of any kind with unreliable or untrustworthy promoters.

It is essential that a co-operative apartment property be competently managed. The efficiency with which the building is operated will have an important effect upon the savings which will result to co-operative apartment owners. The directors of co-operative apartment corporations always reserve the right to control the management of their properties, but usually entrust the details of such management to experienced real estate organizations which are properly equipped to handle them.

Co-operative apartment owners must be persons of respectability and responsibility. The comfort of every such owner will depend to a large extent upon his being assured of having neighbors of good character. The value of an apartment property cannot long be maintained without a high quality of occupancy. A co-operative enterprise cannot function smoothly unless all of the co-operative owners are persons of sufficient financial responsibility to pay the maintenance charges in respect of the apartments which they occupy.

When the supervision of the sales of co-operative apartments in, and the management of, a particular building are entrusted to a competent real estate organization, the investor is assured that his associate investors will be persons of character and standing who will be neither objectionable as tenants nor irresponsible as lessees. He is also assured that his associates will be persons who will be likely to co-operate with each other and take a constructive interest in the common

enterprise. He can assume that the business administration of the affairs of the co-operative apartment corporation will be efficient and along sound and well-established lines. He can also assume that operating matters will require very little of his attention.

The success of a co-operative apartment enterprise which is organized to operate a leasehold property will always also depend to a large extent upon the nature of the terms upon which the leasehold is granted. These terms must be fair to the co-operative apartment corporation as the holder of the leasehold and such as will not permit the lease to be terminated for any trivial cause. The original valuation of the land upon which ground rentals are to be based must not be excessive.

The success of a partially co-operative apartment enterprise will always also depend to a large extent upon the allowances made for contingencies which may arise in connection with the renting of apartments which are not occupied by members of the co-operative ownership group. Ample allowance must be made for vacancies, decorating, advertising expenses, renting commissions, repairs and replacements in the rented apartments. Adequate provision must also be made for the gradual reduction of the mortgage indebtedness of the partially co-operative apartment corporation to an amount which can readily be refinanced. The rental values of all apartments which are to be rented must be conservatively estimated and an allowance must be made for the possibility that such apartments cannot be rented for their full market value.

It would seem that the investment problem of the purchaser of a high-class modern co-operative apartment is no more difficult than that of the purchaser of any other kind of high-class residential property, while his operating problems are both fewer and easier. An investor who contemplates the purchase of a co-operative apartment usually needs the same quality of honest and disinterested advice that he would need if he were contemplating the purchase of any other kind of residential property. Unless he is experienced in real estate operations, he usually needs the advice of a reliable real estate organization and a reputable lawyer. For obvious reasons such an investor cannot reasonably expect to get the best advice unless he consults a real estate organization and a lawyer who are experienced in the organization and conduct of co-operative apartment enterprises.

When the fundamental requirements are satisfied, an investment in a co-operative apartment is a sound investment. It is also a very profitable investment.